FOREIGN ENTRY MODES REVISITED FROM AN ETHICS PERSPECTIVE: CASE OF CROATIA

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As multinational Corporations (MNCs) continue to expand globally they are entering into transitional economies such as Central and Eastern Europe (CEE) in search of new marketplaces. Strategy experts have focused on entry mode strategies such as exporting, greenfield, acquisition, and joint ventures utilizing such theories as agency, transaction cost and institutional in pursuit of explaining the phenomena of foreign market entry. Yet very little research explores the target countries’ personnel factors that may influence the success in entering the new market, and there appears to be a dearth in interplay between a theoretical explanation for entry mode and the ethics of the target market. This research hopes to add this neglected aspect.

Recent research suggests that MNCs alter their strategies in respect to the empowered institutions within the host country (Oxley, 1999; Peng, 2000). A strategy that favors the use of existing institutions may minimize transaction costs (Hoskisson et al., 2000). This view becomes increasingly difficult in transition economies where the institutional framework is unstable due to the changing from a centrally planned economy to a market economy (Swaan, 1997). Although institutions are being developed in CEE (EBRD, 2003), networks of relationships still is the norm for business operations (Stark, 1996; Puffer, 1996; Meyer, 2001). Although institutions may alleviate transaction costs in an unknown target host market by utilizing existing institutions, they are doing so through the host country’s personnel, their relationships, and their knowledge of navigating the business landscape. Therefore, firms entering transitional economies that rely on personal relationships as the motus operandi must understand the target market’s personnel’s ethics as this will not only be the focus of their success, but also their potential downfall.

Ethical norms for business practices differ across countries by intensity and variety and managers entering transitional economies must be able to staff their divisions understanding this dilemma (Al-Khatib, et. al., 1995). Several researchers have suggested formulation of ethical programs (or aspects therein) that are country specific based upon religion/morality (Rice, 1999) or based upon Hofstede’s (1980) cultural determinants (Weaver, 2001). Thus, the realm of current organizational theory on global ethics has been subjected to validation that is relative to the social context of both the managers’ home country and the traditions of the international management field (Peter and Olson, 1983).

As firms move throughout the evolution from domestic, international, multinational, and then towards a global orientation, ethics programs will most likely also require reevaluation and adjustment. The local laws and customs may control a purely domestic firm, while the progression towards international and multinational may confound overseas business with foreign customs and laws. Pure adherence to the foreign local custom in each new country (i.e. bribes acceptable, child labor, asbestos and other carcinogenic usage, nepotistic employment practices, etc.) may not be acceptable to global firms as their ethics programs may not be in alignment through the organization. As international strategy consists of employing personnel with differing perceptions of ethics, a MNC must be aware of the distinct characteristics to facilitate adherence to their internal general practices.

This paper’s focus is to provide a word of caution to the recent stream of research that suggests use of institutions for MNCs in transitional economies as a means to overcome transaction costs. First we discuss transitional economies and their importance to the global marketplace and MNCs in particular. Second we explore Institutional Theory in regard to mode of entry for MNCs and begin to develop our Hypothesis. After reviewing the data and results, we conclude and offer suggestions.
Transitional Economies

This research will focus on transitional economies as they have become increasingly important to MNC operations (Arnold and Quelch, 1998; Batra, 1997; Griffith et al., 2001; Luo and Peng, 1999; Simai, 1999; Springer and Czinkota, 1999). Transitional economies are characterized by highly uncertain and dynamic market conditions. As such, the transitional economy context offers a unique opportunity to extend our understanding of global ethics. An emerging economy can be defined as a country that has a high pace of development and a government that is encouraging economic liberalization and the adoption of free-markets (Arnold and Quelch, 1998).

Central and Eastern European (CEE) transition economies are major business opportunities, though complex, as socioeconomic problems (e.g., high inflation and debt, high unemployment, organized crime) hinder MNC’s subsidiaries performance (Tihanyi and Roath, 2002). Even with these issues, the CEE has attracted considerable foreign direct investment (i.e., $110 billion) by 1999 (UNCTAD, 2000) with another $27 billion alone in year 2001 (UNCTAD, 2003).

This paper focuses on Croatia, as a former socialist republic, because it offers some of the greatest opportunities of all transitional economies. Croatia possesses substantial commercial minerals, vast farming areas (3.15 million hectares of agricultural land of which 63.4% is cultivated) and abundant human resources (4.5 million people). Early indicators of the economic impact of the improved business environment re promising: GDP growth rose 4.8% in 2006, up from 3.8 in 2004. Figures for the first quarter of 2007 show a dramatic improvement over the same period last year. Net inflows from FDI rose to 7.8% of GDP in 2006, and unemployment, although still in double digits, has fallen to a ten year low. This growth has been accompanied by economic stability, with inflation a little over 2% for the first few months of 2007.

It has been more than a decade since Croatian commanded economy and communist government crumbled under the pressure of demands for economic and political freedom. The switch to market oriented economy has brought opportunities and challenges to Croatian citizens, as well as hardships especially economy-wise. In addition, Croatia is opening more to the processes of economic integration and globalization in the world that postulate new social and business paradigms of life. While the formal constraints governing the market have been relaxed, Croatia’s economic transition is far from complete. While market transaction mechanisms, free competition, limited governmental intervention and open access to information are characteristic of developed Western markets, barriers to these key economic aspects remain in Croatia. Finally, there exists great uncertainty in business transactions resulting from ambiguity in policy enforcement, rate of projected market advances, etc., heightened by an unstable economic system.

This study focuses on ethical behavior in the highly uncertain and dynamic market of Croatia and how MNCs should be wary of utilizing existing institutions and personnel in their entry mode strategy. In particular, it focuses on the type of employee that would least likely enter into unethical organizational behavior, focus on self-interest, and have personal characteristics that may be detrimental to an organization. Based on a survey of 400 Croatian businessmen and 92 Croatian students, the results dispute the concept of working through established institutions if a firm wishes to have ethical consistency. Or at the very least, MNCs must be wary of utilizing establish networks of relationships and staid institutions in CEEs.
Institutional Theory, Older Employees and Ethics in Transitional Economies

“Organizations require more than material resources and technical information if they are to survive and thrive in their social environments. They also need social acceptability and credibility” (Scott, 2000 (page 237).

Researchers must be aware of the role and effects of institutions in transitional economies in reducing transaction costs (Hoskisson, et al., 2000, Meyer, 2001). This is particularly important in transition economies as firms face high transaction costs such as lack of information about local partners, inexperienced agents, unclear regulatory frameworks, inexperienced bureaucracies, underdeveloped court systems and corruption. Institutional economists and strategists suggest utilizing institutions as the institutions assist in easing the cost of inter-firm business dealings and allow unknown parties to participate (North, 1990; Clague, 1997). As the greater the target environment constrains the optimality of firms’ actions in addition to production factors traditionally emphasized in classical economics, institutions will represent important elements in influencing business activities (Eggertsson, 1990; Greif, 1993).

The development of institutional theory has led to insights in describing the actions of institutions due to their internal and external environmental pressures and concerns (Scott, 1987; Zucker, 1987). The institutional theory views organizations as social entities that seek approval for their performances in socially constructed environments. Organizations conform to gain legitimacy and acceptance, which facilitate survival (Meyer and Rowen, 1977). Internally, institutionalization arises out of formalized structures and process, as well as informal or emergent group and organizational processes. Forces in the external environment include those related to the state (e.g. laws and regulations), the professions (e.g. licensure and certification), and other organizations, especially those within the same sector. Institutional theory may be the antithesis of Transaction Cost Theory (Williamson, 1987: concerns efficiency of an organization) as it demonstrates how non-choice behaviors can occur and persist, through the exercise of habit, convention, conveniences, or social obligation (Oliver, 1991) with rejection that organizational phenomena are the products of rational choice based upon technical consideration (Westney, 1993). Although utilizing the target countries’ institutions to facilitate business in hopes of eliminating transaction costs through their network of relationships, MNCs must realize that the employees’ perspectives of ethical business practices will differ from their own.

Older employees who are seen as having developed a network of relationships to “get things done” in their career under the communist regime may be seen as a valuable commodity to a MNC. Increasing attention has been paid to the adaptation of strategies due to the demands of the institutions in the host economies (Oxley, 1999; Peng, 2000). For transitional economies, evolution of institutions appropriate to become a market economy is critical (Clague, 1997). Lack of knowledge of transitional markets and the functioning of that market will increase transaction costs (Swaan, 1997). Firms will attempt to negotiate the landscape by staffing with employees who can negotiate through the maze of institutions by personal connections and networks. Network based coordination is important in these situations (Stark, 1996; Puffer, 1996).

In a marketplace, high levels of institutions contribute to transactional efficiency by allowing firms to conduct business with unfamiliar but more efficient parties (Greif, 1993; North, 1990). A large quantity of institutions allows firms to become specialized by the availability of market transaction mechanisms (Clague, 1997). Cooperative norms and societal trust
facilitate inter- and intra-organizational cooperation (Putnam, 1993). Local competitions may have developed capabilities for relationship-based management in their environment that substitute for the lack of institutional infrastructure (Hoskisson, Eden, Lau and Wright, 2000). New divisions located overseas may be forced to confront foreign conventional business practices that are in conflict with the overall firm’s ethical behavioral stance. For example, prevalent in post-communist economies is a term of “ironic freedom” (i.e., the freedom of not identifying themselves with the system) and “institutionalized hypocrisy” (i.e., the only hope of individual benefit is to find a way to exploit the exploiters) (White, 1979). Under the communist reign, onerous tax burdens, duties, tithes, and other destructive controls compounded the costly effects of living within the system. The only way an individual could “get ahead” would be to participate in the black market, or circumvent established controls and the established system. MNCs attempting to start operations in these market-types can expect to be met with circumvention and opportunistic behavior. Therefore we suggest that:

**H1**: Older employees will be less ethical than younger employees in transitional economies.

**Gender and Ethics in Transitional economies**

Ethical considerations in regard to gender have been a topic of interest as the number of women taking positions in business has continued to increase (Venkatesh, 1980). Specifically, since men are more concerned with competitive success in business, they may be more prone to break the rules and laws of the MNC and commit unethical acts (Radtke, 2000). Gender is an important consideration in transitional economies as these economies in the past typically were dominated by men during the communist regime, but now women are entering the business world in huge percentages. MNCs will have the opportunity to hire either gender and guidance would assist MNCs in tailoring ethical business practices in transitional economies. This new group of individuals (female) entering the business community may not have the established network of relationships, but could effectively counter-act possible ethical dilemmas. For example, females are more willing to participate in whistle-blowing in their place of employment (Sims and Keenan, 1998; McDaniel, Schoeps and Lincourt, 2001). It is in this context, i.e. the transitional economy, that the role of women as an important human resource, is critical given the highly unstable environment and the existing knowledge gap between local and foreign partners (Si & Bruton, 1999; Springer & Czinkota, 1999; Steensma & Lyles, 2000).

Over the years, our understanding of gender differences in organizations has resulted in a significant body of work (for extensive reviews see Eagly 1995, 2003). Gender studies in the United States have suggested that females are more ethical than males. Females are bound to adopt a more ethical stance than their male peers (Weeks, 1999; Clark and Barry, 1997). There are other studies that have mixed results where there is no difference on ethical judgment between males and females (Schminke, 1997; Singhapakdi and Vitell, 1990; Fritzche, 1988) so we hope to provide further efforts in exploring this phenomenon in the setting of a transitional economy. Although much of the research surrounding her work has focused on personal situations, some studies have directly tested Gilligan’s theory in organizational settings. We, therefore, address the issue of criteria that women perceive as important factors for their career advancement in terms of cognitive moral development, best described as a person’s perception of what is right and wrong (Everett, Thorne & Danehower, 1996), i.e. acceptable or non acceptable.
Males tend to be more concerned with achievement, advancement and power while females tend to value harmonious relationships and nurturing attitudes (Gilligan, 1982). Therefore we suggest:

**H2:** Women in transitional economies will be more ethical than men.

**Education and Ethics in Transitional economies**

Previous research has suggested that education and ethics should be positively related (Yoo, 2002). Business schools have focused on not only preparing students with the basic tools, but also are trying to influence their ethical behavior. Increasingly so, colleges and universities in the undergraduate level and more so in graduate schools are including in their curriculum ethics either as a stand alone course, or is interspersed throughout coursework. Business schools have added a mandatory ethics class to the degree program as an independent course or a component of existing coursework, partly in response to the accreditation standards set by the American Assembly of Collegiate Schools of Business (AACSB) (Gunz and McCutcheon 1998; Polonsky 1998). Our research explores whether these pressures have been applied internationally, and in particular, transitional economies such as Croatia.

Also the higher the educated the employee, one would assume several other factors that would influence their ethical decision making. First, they would have been exposed to not only other students but knowledge of appropriate business practices. Secondly, educated business students will have more knowledge and compunction based upon their education to discern correct courses of action. Finally, the reputational effects of unethical behavior would be apparent to a student who has been educated.

**H3:** The higher the education levels of the employee the greater their ethics.

**The Study**

**Sample**

Data used to test the hypotheses consisted of 400 Croatian businessmen and 92 Croatian students. The four hundred Croatian businessmen were initially contacted via mail. Multiple follow-up phone calls and e-mails were used to stimulate additional responses. The 92 students were administered the questionnaire in the classroom. In all, three hundred and four Croatian businessmen responded to the questionnaire, for a 76.0% response rate, and all 92 students participate for a 100% response rate. Respondents represented ages from 20-67, encompassing a wide range of industries including agricultural, biotech, chemical, electric equipment, leather, naval technology, plastics, printing, rubber manufacturing and electronics. Firm sizes were from under 100 employees to over 1000. Education levels varied from non-College educated to Doctorate holders. Thirty-four percent (34.5%) of the respondents were middle to upper management while the remaining 55.5% being line managers or non-managers. Of the respondents, 48% were male.

**Pre-test**

Pre-testing was conducted in two stages. The first stage consisted of refining the English version of the survey instrument. We used Schwartz’s (1992, 1994) values model. The initial survey was developed based upon pre-existing measures developed for and used within the United States. International market researchers, business professionals, and translators were used to examine the proposed survey packet with modifications made to minimize misinterpretation.
Next, the survey instrument was translated into Croatian by an independent translator and back-translated by committee (cf., Brislin 1970; Sperber, Devellis and Boehlecke 1994). The survey instrument was checked for form and meaning equivalence with adjustments being made as necessary (cf., Sperber et al. 1994).

Measures

Independent Variable:

Our questionnaire measured Ethical orientation based upon previous literature and single-country research. Ethical orientation was measured utilizing items measured on a nine point, Likert-type scale. The scale assessed the respondent’s disagreement or agreement based upon Strongly Agree, Moderately Agree, Neutral, Moderately Disagree, and Strongly Disagree with the anchors of 1 for Strongly Agree and 9 for Strongly Disagree. Similar perceptual scales have been commonly used in studies of HRM practices and organizations (e.g., Fey and Bjorkman, 2001; Ngo et al., 1998). Items included “give priority to ethical principles over economic benefits”, “refrain from bending the law even if doing so could improve performance”, “abide by contractual requirements even if doing so would be costly”, etc.

Dependent Variable:

The study used very straightforward measures. Respondents were asked their age in years. Their gender was either male or female. Subjects’ education was measured according to the following 6 categories: 1) 4 or fewer years completed, (2) 5 to 8 years completed, (3) 9 to 12 years completed,(4) 13 to 16 years completed [Bachelors degree], (5) Masters degree, and (6) Doctorate degree. Respondents were also categorized according to “Type”, whether they were from the student sample or from the business sample.

Control Variables:

Data were analyzed using correlation analysis and regression analysis. In the regression analysis, several control variables were also included. We included size of the company as a control since firm size larger firms have more resources to devote to business. Also firm size is important as the larger the institution the greater the pressures for employee to conformity of the institutions norms and culture. Firm size was measured according to three criteria: (1) Less than 100 employees, (2) 100 to 1000 employees, and (3) More than 1000 employees.

Finally, to further control for the potential impact of other factors, we ran separate regression analyses (with industry categorized in the following groups: 1) Agriculture, mining, forestry, fishing, (2) Construction, (3) Manufacturing, (4) Transportation, communication, utilities, (5) Wholesale and retail trade, (6) Finance, insurance, real estate, (7) Services (example: hotel, restaurant), (8) Public administration, (9) Health care, and (10) other). None of these control variables were significant, and thus they were dropped form the regression analysis reported here in this article to preserve degrees of freedom.

Results

Table 1 provides the means, standard deviations and bivariate Pearson correlations for the main variables used in the general linear model. Ethics was positively correlated with age, gender and type, but not correlated with education. The result provides preliminary support for all of our hypothesis except that of education and ethics. A more refined analysis to test these hypothesis, however, will follow.
General linear modeling was used to test our specific hypothesis. Table 2 shows the results of the general linear model for ethics in transitional economies. The model was significant with an $R^2$ of .196. Age, Gender and an interaction of Age and Gender were significant providing support for Hypothesis 1 and 2. Further post hoc analysis illustrated that the gender for being more ethical is female. Also, that the older the individual the less ethical. However there was no significant relationship between Education and Ethics, thus providing no support for Hypothesis 3.

### Table 2

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</table>

** R Squared = .196

Discussion and Conclusion
The results of this study provide a relatively strong support for the existence of a positive relationship between ethics in transitional economies, or specifically in Croatia, and gender and age. The implications are important for human resource management and strategy researchers and managers. As global business has become the norm, our understanding of foreign markets continues to be a focus of research.

Recent strategy research suggests the use of local institutions to lower transaction costs in transitional economies, yet this strategy may be fraught with personnel ethical norms that have been institutionalized during the centrally planned market economy. This research acts as a warning to those strategy scholars advocating such a strategy to be aware of the human aspect and the related ethical considerations of the personnel within an established bureaucracy. This research does not suggest that this strategy is not the course of action to be taken, but to make those aware of the pitfalls of such actions.

As the Central and Eastern European (CEE) transition economies continue to grow in importance and MNCs enter, the complexity and socioeconomic issues of the market may challenge management to utilize established channels and local firms. This research is a beginning to assist MNC subsidiaries in regard to the ethical considerations in staffing. Our findings suggest that women are more ethical than men. This finding is supported by domestic research in the United States. Many women are now entering the business market in Croatia as well as in CEE, so MNC subsidiaries should be aware of these individuals to uphold the corporation’s ethical posture.

This research suggests that contrary to intuition, younger individuals tend to be more ethical than older individuals. This is likely due to the network of relationships developed and working outside of the system by older individuals influenced by the ex-communist regime. Accordingly, many of the older workers knew how to beat the system and work outside of the rules. The younger generation who have been exposed to the somewhat free market economy, tend to be more ethical as they have not been institutionalized into circumvention of controls and norms.

Surprisingly, the level of education in regard to respondents and their ethics was not significant. We can only argue that educators in CEEs and Croatia understood the dilemma practitioners had to be successful in a centrally planned marketplace so did not discourage unethical behavior. Also, though ethics can be taught, the practicality of application is not important if not supported. The take away for this is that MNCs must develop and then support ethics programs, as training alone without headquarter support will not be effective.

Like all research, the present study has several limitations. Our paper begins to explore the question of causality. However, causality can actually be tested only with data collected at different points in time which future studies are urged to include. While this study makes important contributions to researchers understanding of ethics and transitional economies such as Croatia, further research should entail.

Future research could explore other transitional economies and compare the findings to see if Croatia is atypical of transitional economies in Central and Eastern Europe. Performance implications of ethical versus unethical behavior in these markets would also provide further exploration of this phenomenon both at the subsidiary level as well as global. Further, the long-term implications (versus short-term) of firm performance on ethics of employees in this type of market place should also be explored. Also, degrees of ethical behavior could be explored as it could be argued that since ethics is country specific, slight unethical behavior, or borderline ethical behavior may not only be a business norm, but
required. Contrarily, any degree of unethical behavior may affect long term performance, so future research could explore these many dimensions.

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